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Recommendations on Accounting Principles

The Accounts of Holding Companies

The seventh of a series of Recommendations on Accounting Principles was recently approved by the Council of the Institute of Chartered Accountants in England and Wales and published in *The Accountant* as follows:

"The Council of the Institute of Chartered Accountants makes the following further recommendation to its members on certain aspects of the accounts of companies engaged in industrial and commercial enterprises. Whilst it is recognised that the form in which accounts are submitted to shareholders is (subject to compliance with the Companies Act) a matter within the discretion of directors, it is hoped that this recommendation will be helpful to members in advising, in appropriate cases, as to what is regarded as the best practice.

VII. Disclosure of the Financial Position and Results of Subsidiary Companies in the Accounts of Holding Companies

Where a company holds a direct or indirect controlling interest in another company or companies (referred to in this memorandum as 'subsidiary undertakings'), a true appreciation of the financial position and the trend of results of the group as a whole can be made only if the accounts of the holding company as a separate legal entity take into account or are supplemented by information as to the financial position and results of the subsidiary undertakings.

The following are three methods of disclosing this supplemental information. Each has its own value and limitations. The first and second methods are suitable only in special cases.

Method (1): To submit copies of the accounts of each of the subsidiary undertakings.

This method is suitable only where it is desired to focus attention on the financial position and earnings of each component of the group. It is impracticable where the companies are numerous and, in all but the simplest cases, the shareholders of the holding company could not obtain a true view of the group as a whole without considerable explanation of inter-company relations.

Method (2): To submit statements of the consolidated assets and liabilities and of the aggregate earnings of the subsidiary undertakings as distinct from those of the holding company.

This method is of value where it is desired to show the underlying assets which represent the investment of the holding company in its subsidiary undertakings, or particular groups of them, and also the earnings attributable thereto.

Note: As regards methods (1) and (2), if the holding company trades extensively with or through its subsidiary undertakings, the disclosed earnings of the subsidiary undertakings may not by themselves be a true criterion of the real value of the holding company's interests in such undertakings; in such circumstances their value cannot be assessed separately from the value of the group undertaking as a whole.

Method (3): To submit a Consolidated Balance Sheet and a Consolidated Profit and Loss Account of the holding company and of its subsidiary undertakings treated as one group.

This method is the most suitable for general application.

It must, however, be remembered that a Consolidated Balance Sheet is not a record of the assets and liabilities of a legal entity and that the liabilities of each company in the group are payable only out of its own assets and not out of the combined assets of the group. Also, there may be special cases where it may be impracticable or inappropriate to include the figures of a particular subsidiary undertaking in the consolidation. This applies especially in the case of subsidiary undertakings operating overseas where, apart from the temporary difficulty of enemy occupation, there may be restrictions on exchange.

A Consolidated Profit and Loss Account does not suffer to the same extent from these limitations and, subject to any necessary explanations, the aggregate results of the group as a whole can be stated. Such disclosure is important even if for any reason the publication of a complete Consolidated Balance Sheet is impracticable or inappropriate.

Recommendations:

It is therefore recommended that in the case of every holding company:

1. With the published accounts, statements should be submitted in the form of a Consolidated Balance Sheet and Consolidated Profit and Loss Account or in such other form as will enable the shareholders to obtain a clear view of the financial position and earnings of the group as a whole.
2. Every consolidated statement should indicate:
   (a) The nature and measure of control adopted as a basis for the inclusion of subsidiary undertakings.
   (b) The reasons for the non-inclusion of any subsidiary undertakings which would normally be included on the basis adopted for the group.
   (c) The procedure adopted in cases where the accounts of subsidiary undertakings are not made up to the same date as the accounts of the holding company.
   (d) In the case of subsidiary companies operating overseas, if relatively important, the basis taken for the conversion of foreign currencies as affecting assets, liabilities and earnings.
3. The Consolidated Balance Sheet should exclude inter-company items and should show the combined resources of the group and its liabilities and assets, aggregated under suitable headings. It should distinguish between capital reserves not normally regarded as available for distribution and revenue reserves, including those which would be available for distribution as dividend by the holding company if brought into its accounts. It should also show the interests of outside shareholders in the capital and reserves of the subsidiary undertakings and, under a separate heading, the interests of the group in subsidiary undertakings which have not been consolidated.
4. The Consolidated Profit and Loss Account, or other information given

as to the earnings of the group, should disclose the aggregate results of the group for the period covered by the accounts, after eliminating the effect of inter-company transactions. It should be in such a form that these aggregate results may readily be reconciled with those shown by the profit and loss account of the holding company, in which should be stated separately the aggregate amount included in respect of subsidiary undertakings whose accounts have not been consolidated.

The following, *inter alia,* should be separately stated:

(a) The aggregate results of any subsidiary undertakings, the balance sheets of which have not been included in the consolidation.

(b) The portion of the aggregate net results attributable to outside shareholders' interests in the subsidiary undertakings.

(c) The portion of the consolidated net results attributable to the holding company's interest which remains in the accounts of consolidated subsidiary undertakings or the amount by which the dividends from such subsidiary undertakings exceed the holding company's share of their earnings for the period.

5. Profits earned and losses incurred by subsidiary undertakings prior to the acquisition by the holding company of the shares to which they are attributable should be viewed as being of a capital nature from the standpoint of the holding company. Such pre-acquisition profits (whether received in dividend or not) should therefore not be brought into account as being available for distribution in dividend by the holding company."

This pronouncement gives official support to methods that have been evolved by members of the profession over a term of years, and it will serve as a useful guide to accountants both in Great Britain and elsewhere.

The provisions of the English Companies' Act, which were followed in the Acts of New South Wales, Queensland and South Australia, offered no solution to the important problem of the presentation of the accounts of Holding Companies, but a notable advance in legislation relating to this subject was made (in the face of considerable opposition from a section of the accountancy profession) in the Victorian Act of 1938.

In its provisions as to the presentation of such accounts this Act prescribed that there should be annexed to the accounts of the holding company, either:

(a) a separate profit and loss account and balance sheet for each of the subsidiary companies, or

(b) a consolidated profit and loss account and a consolidated balance sheet of the holding company and its subsidiary companies, and in addition a statement showing the total losses (if any) of the subsidiary company or companies.

These provisions, and the action of the Melbourne Stock Exchange (which had previously included somewhat similar provisions in its official list requirements), have been responsible for a marked improvement in the published accounts of holding companies in Victoria, but the Act naturally gives very little information concerning principles relating to the preparation of consolidated statements.

The pronouncement by the Council of the Institute of Chartered Accountants in England and Wales gives, in a short compass, all the important principles and also some comments as to the suitability of three different methods—the first being suitable only in the simplest cases where there are only a few subisidiary companies, and the second where the parent company does not trade with or through its subsidiaries. The third, the Consolidated Statement of the holding company and its subsidiaries, meets with most approval, being suitable for "general application."

The use of explanatory notes as suggested in Recommendation 2 would add clarity to the statements and avoid possibilities of misconception. Though the recommendation indicates that variations in balancing dates of the holding company and its subsidiaries are no obstacle to the preparation of consolidated statements, the desirability of introducing a uniform date, wherever possible, cannot be stressed too strongly.

The consolidated profit and loss account is a more important statement than the consolidated balance sheet, and its preparation may involve greater problems than the preparation of the consolidated balance sheet. Recommendation 4, therefore, deserves careful consideration. The requirement that the "aggregate results may readily be reconciled with those shown by the profit and loss account of the holding company" may not be widely understood, but it is nevertheless important. The example shown on pages 144-5 of the March, 1938, issue of this journal illustrates this point.

In Recommendations 3 and 5 attention is drawn to the need for distinguishing between surpluses available for distribution and those of a capital nature. Profits of the subsidiaries earned prior to acquisition belong to the latter class, and, if distributed to the parent company they must be regarded by it as a realisation of part of its investment in the subsidiary.

As in the case of the previous recommendations on accounting principles, this recommendation on the presentation of holding companies' accounts is advisory only and is intended to support advice that may be given to directors of such companies.

However, it is quite clear that consolidated statements are regarded as an essential part of the published accounts of holding companies. The Council of the Institute is to be congratulated on the clarity and comprehensiveness of the recommendation which is a valuable contribution to an important topic.

Valuation of Sheep Station Properties (Western Australia)

By R. F. Rushton, F.I.C.A.

I am aware that accountants generally are confronted with difficult problems when asked to determine values in relation to the assets in station properties. It has been quite a regular practice to engage the services of a reputable and responsible pastoralist to undertake the work of valuation when such has been necessary and, in the main, valuations obtained in this way have had regard for the sheep-carrying capacity of the property, the subject of valuation, and the value thus obtained has been based upon a figure of so much per head (27/6 or 30/-) of such carrying capacity.

On the other hand some valuers have had regard for the lease or unimproved land value plus the present day worth of the improvements, plant and live stock. These methods may prove to be unreliable in that, in the first instance, the figure as to carrying capacity of a property may not have had regard for a long-term review of the station's history and may be prejudiced in no small measure by the peculiarly present view immediately available to the valuer whilst, in the second instance, any valuation based on cost of assets without regard for the earning capacity of the property as an economic unit might quite conceivably prove out of relationship with fact.

My experience has prompted me to confront the problem and deal with it by extracting, from the records of the ownership of the property, figures which would give me, say, over a twenty years' period:

(1) The average carrying capacity;
(2) the average wool return;
(3) the average wool return per sheep carried;
(4) the average net profit return revealed in the profit and loss accounts of the concern (eliminating interest and extraneous accounts);
(5) the current assets value as revealed in a present-day balance sheet eliminating such items as goodwill, debtors, wool on hand, stores on hand, investment account or other extraneous accounts.

Having gained the foregoing information, I would purpose viewing the asset value from three angles.

Firstly: *Capital value based on Net Return disclosed in accounts (interest account excluded).*

Argument will be brought forward that a minimum yield of 10% should be looked for, but I would suggest to the reader that by taking figures covering a long-term view of the asset, it can be reckoned that most hazards involved would be cared for. The more clearly to illustrate the position in this regard, I would instance the position of a station ownership bearing a reliable history over a twenty years' period. It would be quite feasible for such ownership to have, by way of bank or brokers' advances, an amount equal to, if not more than, 50% of the total asset value on loan at a banker's rate of interest, and from this it is considered that it is reasonable to regard 50% of the asset value as in the nature of a gilt-edged investment with the remaining 50% carrying the hazards or risks and justifying a higher return. A mean is assessed at 7% and this return has been required in my calculations under this heading.

Secondly: *Capital value based on Average Carrying Capacity.*

The second angle would have regard for the average number of sheep carried and having before me the figures revealed from the records, it would remain for me to discover whether the property under review had been managed properly and that the fullest advantage had been taken of the capacity of the asset in order to ensure that the figures placed before me could be accepted as indicative of a yardstick of value.

To aid me in this, I would have regard for the figure giving the average wool return per sheep, which would, to some extent, guide me as to the general management of the concern. If the average wool return were low and no very good reasons were advanced in explanation thereof, I would be entitled to assume that the management, being weak in this regard, would be weak generally.

Having satisfied myself as to whether the figures given were to be accepted, I would seek to value the property on the basis of, say, 27/6 or 30/- per head of the average carrying capacity. The figures given represent those generally used, although within various zones other figures are adopted. This submission is with the object of establishing general principles only, and it must be accepted that the various yardsticks would possess a measure of flexibility having regard to local condition and like factors.

From or to the figure obtained in this way, an adjustment will require to be made on account of the difference between the average carrying capacity and the actual number of sheep carried as at the date on which it is necessary to have the value of the property determined. This adjustment is necessary in order that shortages or surpluses in the present-day position can be cared for. Surpluses can be reasonably held to represent culls, whilst shortages would have to be provided from current values in sheep. This factor must not be overlooked.

Thirdly: Capital value based on Value as Disclosed in Present-day Balance Sheet of Ownership.

The third angle has regard for the present-day value as set down in the balance sheet of the ownership, and provided the records have been regularly kept and assets depreciated in none other than a normal manner, the balance sheet figures as to assets should be accepted with the exception of the accounts listed above and subject to the bringing into account of sheep figures at present-day values. It is recognised that the asset values returned in the ownership balance sheet would have considerable merit, but I hold such figures must be tempered by regard for the carrying capacity of the property and the net returns yielded over the years.

My findings will probably give me figures which, in the first instance, will appear out of balance, and to achieve the desired result I take a mean of the figures obtained under the three headings. This mean is the figure we would set down as representing the present-day value of the station property.

The working may be illustrated by the following *pro forma*:

Example

Angle 1

Capital Value Based on Net Return Disclosed in Accounts (Interest Account Excluded)

Profit and Loss Account

Year	Profit	Loss
19—	—	—
—	—	—
—	—	—
—	—	—
—	—	—
/	/	/
Totals		
Deduct Loss total		
Total Profit yielded for period =		
Average =		
Capitalised (a) 7% =		

Angle 2

Capital Value Based on Average Carrying Capacity

Average carrying capacity having regard for 20 years' history = A

A x 27/6 (or 30/-) = B

Adjustment

Say actual sheep carried at date of review were 4000 less than average, then a deduction would require to be made from "B" of an amount

4000 x present-day cost of sheep.

Angle 3

Capital Value Based on Assets Value as Disclosed in Present-day Balance Sheet of Ownership

TOTAL ASSETS =

Less: Goodwill
Investment A/c
Debtors' A/cs
Wool on hand
Stores on hand
Other extraneous A/cs

ADJUSTMENT

1. *Sheep taken into a/c at, say, 6/-*
2. *Actual value, say, 10/-*
3. *Difference brought to Account*
   Number of sheep x 4/- =

Conclusion:
Summary of Values:
1 =
2 =
3 =

Total:

The mean of these =

Book Review

Publications of the Bureau of Business Research of the College of Commerce, University of Kentucky, Lexington, U.S.A.

"The people of a State have a right to full information concerning the operation of their government. As agents of the people, the two General Assemblies, the Court of Appeals, and the executive and administrative staff share with me (the Governor) the responsibility for governmental progress."

This paragraph is an extract from a foreword in a small official publication, *Kentucky Government, 1939 to 1943.*

Both the Government and the Report make an instant appeal for the following achievements during the period: (1) Paid State debt in full and accumulated a substantial surplus; (2) Operated on a rigidly controlled budget and underspent £3,125,000; (3) Reduced the number of State employees in departments under the direct control of the Governor by 1,750; (4) Selected personnel by individual examinations upon basis of qualifications, while (5) Advancing to fifteenth place among the States in the number of aged citizens receiving pensions.

Another useful publication from the same State is *Kentucky Incomes—a statistical study of the Tax Returns for 1941 and 1942.* Released by the Commissioner of Revenue in February of this year, he has submitted the report based on a statistical study of the tax returns for the two years. The data showing the amount and distribution of income in the State sheds light on questions of public policy and furnishes a useful background for plans of the business community.

W. BRUCE RAINSFORD.

Taxation Section

Edited by J. A. L. GUNN, F.I.C.A.

EXEMPTION OF PAY AND ALLOWANCES OF MEMBERS OF DEFENCE FORCES

Section 23 (s) of the Principal Act has been omitted by Act No. 3 of 1944 and a new paragraph (s) has been inserted in its stead.

The previous and present paragraphs exempt the pay and allowances earned outside Australia by a member of the Defence Force.

In addition, old s. 23 (s) exempted the pay and allowances earned in Australia during any income year, if, within twelve months after the close of that year, the member embarked for service outside Australia (or in the case of Naval personnel, served in a sea-going ship) and remained on service outside Australia, or was borne in a sea-going ship, for a period of, or for periods aggregating, six months during the twelve months immediately following the date of embarkation. The exemption also applied if, prior to serving the specified period of six months, the member was returned to Australia owing to injury or illness.

Where a member was exempt under the above provisions, the exemption continued to apply to a member's pay and allowances derived after his return to Australia until the expiration of three months after his resumption of duty in Australia.

The Commonwealth Treasurer stated in his Explanatory Memorandum that, owing to the proximity of the fighting to the Australian mainland, units of the Forces have been brought back for rehabilitation before the expiration of six months from the date of their departure; consequently the members of those units did not qualify under old s. 23 (s) for the retrospective or prospective exemption of pay and allowances earned by them in Australia. To meet the altered circumstances, new s. 23 (s) provides that the qualifying period during which a member of the Defence Force should serve outside Australia or be borne in a sea-going ship is reduced from six months to a continuous period of 90 days. The previous qualifying aggregate period of six months continues to operate (but altered to 180 days) in the case of broken periods of less than 90 days' duration.

The exemption of pay and allowances earned in Australia prior to service out of Australia or prior to service in a sea-going ship also applies where, before the expiration of the period of 90 days, a member dies or, owing to injury or illness, he is returned to Australia or is discharged from his ship.

New s. 23 (s) also maintains the exemption in respect of pay and allowances earned in Australia during the period of three months after the member's resumption of duty in Australia. There is, however, a change in the wording of this exemption. Old s. 23 (s) provided for the exemption of pay and allowances "(iii) in Australia until the expiration of the period of three months immediately following his resumption of duty in Australia if he is a member whose pay and allowances have been exempted *under the preceding provisions of this paragraph.*" The preceding provisions of old s. 23 (s) provided for the exemption of pay and allowances earned (i) out of Australia and (ii) certain pay and allowances earned in Australia prior to specified service abroad. If "under the preceding provisions" should be held to mean *any* of those provisions, then a member would be entitled to the exemption under old s. 23 (s) (iii) if his pay and allowances had been exempted under old s. 23 (s) (i), i.e., in respect of service out of Australia, however brief that period of service might be. Under new s. 23 (s) (iii) (1) the exemption applies to pay and allowances earned in Australia until the expiration of 90 days immediately following the member's resumption of

duty in Australia if he is a member whose pay and allowances have been exempted under present s. 23 (s) (ii) (1) or previous s. 23 (s) (ii), i.e., only if some portion of his pay and allowances prior to service outside Australia or in a sea-going ship were exempt from tax.

New s. 23 (s) also extends the concession to members of *air crews* of R.A.A.F. squadrons stationed at operational stations in Australia and engaged in operational flights outside Australia, and who have been attached to the squadron for a continuous period of 90 days or broken periods aggregating 180 days during the twelve months immediately following the date of being posted to the squadron. These members of the R.A.A.F. will receive the same exemption from Commonwealth income tax in respect of their pay and allowances earned in Australia as that granted to members of R.A.A.F. squadrons who are on service in New Guinea and other places outside Australia. For the purpose of this exemption "air crew" is defined to include photographers and members of the ground staff whose duties require them regularly to take part in flights out of Australia. The exemption does not, however, apply to members of reserve squadrons unless those squadrons take part in operations as operational squadrons for a continuous period of 90 days.

New s. 23 (s) applies in respect of pay and allowances earned during income year ended June 30, 1942, and subsequent years.

Non-application of Division 7 to Certain Non-resident Companies

Section 109A, which was inserted in the Principal Act by Act No. 58 of 1941, provided that Division 7 should not apply to a private company which is a non-resident and does not carry on business in Australia by means either of a principal office or a branch. As officially stated the view taken was that as the Commonwealth does not collect tax in respect of dividends distributed by non-resident companies to non-resident shareholders, the principle underlying the imposition on companies of income tax on undistributed profits has no application in the case of a non-resident company which does not carry on business in Australia by means either of a principal office or a branch. However, s. 109A, in its original form, had the unintended effect of excluding non-resident private companies from the benefit of the rebate provided by s. 107 in respect of dividends paid by a resident private company to a non-resident private company.

By Act No. 3 of 1944, s. 109A was amended so as to exclude from its operation the provisions of s. 107. This amendment was made retrospective to assessments for the financial year 1940-1941 (year of income ended June 30, 1940, or substituted accounting period), i.e., the first assessment to which s. 109A was made to apply.

Undistributed Income of Insurance Company Re-insuring with Non-resident

Under s. 148 an insurance company carrying on business in Australia is not allowed a deduction of re-insurance premiums paid by it to a re-insurer not carrying on business in Australia. On the other hand, the non-resident re-insurer is not assessable in respect of the re-insurance premiums so received and the Australian company is not required to include in its return sums recovered from the non-resident re-insurer in respect of any risk so re-insured.

As officially explained, the effect of s. 148 is to cause the Australian insurance company to be assessed in respect of the full profit, or to be allowed the full loss, arising from the risk insured, although part of that profit or loss is, in fact, derived or sustained by the non-resident re-insurer. The profit on

the overseas re-insurance business forms part of the taxable income of the local insurance company, although it is, in fact, not profit derived by or available for distributions, as dividends by the local company.

Section 160A has been amended by Act No. 3 of 1944 to provide, *inter alia*, that, in the case of a company carrying on the business of insurance in Australia, its taxable income, for the purpose of Part IIIA, shall be deemed to be the amount which would be the taxable income if s. 148 did not apply to the company.

The object of the above amendment is to place outside the scope of the tax on undistributed income any profits made by non-resident re-insurers from re-insurance business effected with them by insurance companies carrying on business in Australia. Corresponding to the exclusion of this profit from the local company's distribution income, any loss arising from overseas re-insurance business will be added to the taxable income in ascertaining the distributable income of the local company.

The Australian company is allowed a deduction of any income tax or war-time (company) tax paid or payable in respect of the full profit arising from the risk insured. There are instances where the non-resident re-insurer reimburses the Australian company the amount of the tax attributable to the re-insurance profit. Section 160A has been amended by Act No. 3 of 1944 to provide that the amount of any such reimbursement shall be included in the Australian company's distributable income of the year of reimbursement.

The above amendments apply to assessments for the financial year 1943-1944 (i.e., to year of income ended June 30, 1943, or substituted accounting period) and all subsequent years.

Corresponding alterations have been made to Division 7, which relates to the tax on undistributed incomes of private companies.

Suggested New Method of Taxing Private Companies

By Donald E. Rollason, a.c.a. (aust.), and
James M. Greenwood, a.c.a. (aust.)

The present method of taxing private companies is under review, and from the published report of the Taxation Advisory Committee it appears that radical changes are imminent.

At present, business enterprise is carried on broadly in three separate forms, each with its own tax status:

(a) Public companies.

(b) Private companies.

(c) Partnerships or sole traders.

For taxation purposes the private company to-day occupies an intermediate position between the public company and the partnership or sole trader and it has been suggested that the law be amended so as to disregard its separate legal entity and tax it as a partnership, or alternatively, to tax it as though it were a public company, thus removing all "tax-free" dividend concessions.

Disadvantages associated with the existing system of levying private company tax include

(i) The complicated basis of calculating the tax and the resultant delays in the issue of assessments.

(ii) With many companies it is impossible either to estimate the amount of tax payable or to check the assessment.

(iii) The allowance of private company tax paid as a deduction in determining "undistributed income" creates inequities such as the granting of a tax benefit to large-income shareholders disproportionate to that obtained by shareholders in the same company with small incomes. It has been suggested that the deduction of private company tax paid may be withdrawn. If the Government accepts this suggestion, an unintended effect will be to intensify the injustice suffered by the small-income shareholder. Further, the tax situation which will arise if private company tax paid is disallowed lends itself to unscrupulous withholding of dividends designed to create conditions whereby not only do small-income shareholders bear a disproportionate share of the tax burden, but also the value of a company's shares may be forced down in order that small-income shareholders may be forced to sell out cheaply.

(iv) The revenue suffers a loss of tax through the non-aggregation for rating purposes of a taxpayer's interests in the incomes of more than one private company.

Set out hereunder are details of a system of taxing private companies adapted from the tax system applied to companies in the United Kingdom, which we put forward for adoption in Australia with a view to meeting many of the existing difficulties with which the legislature is faced:

1. Private companies no longer to pay ordinary Federal income tax at 6/- in the £, but instead to pay one tax only—a flat rate of private company tax.
2. The flat rate of private company tax (say 13/- in £) to be applied to the Federal taxable income calculated as at present.
3. The tax to be paid by the company and to be collected as follows:
   (a) If any dividend or dividends are declared out of the taxable income before the assessment is paid the tax upon the profits comprised in the dividend (i.e., 13/- in the £ on the amount of the dividend) to be deducted from the gross amount otherwise payable to the shareholders and paid to the Commissioner within 14 days of the date of payment of the dividend. At the same time a list would be furnished to the Department (like the old Form "D" in New South Wales) showing the shareholder's name, the gross dividend and the tax deducted. Alternatively, a certificate to be made out in triplicate for each shareholder, showing the same particulars—one copy to be forwarded to the Department, one to be retained by the company, and one to be sent to the taxpayer to be used by him as a Certificate of Credit—see paragraph 4 below.
   (b) An assessment to be made on the company for the full amount of the tax, but the interim payments made as dividends were declared to be treated as payments on account and deducted, leaving a balance to be met by the due date which would be stated on the assessment notice as at present.
4. Shareholders to receive with each dividend cheque a Certificate of Credit from the company showing their name, the gross amount of the dividend, the tax deducted in respect of the dividend, the name of the company and the company's file number. Alternatively, the amount of the Certificate of Credit to be calculated by applying to the dividend the flat rate of private company tax ruling at the date of payment of the dividend. Shareholders would use these certificates for payment of tax in the same way as a group certificate for wages and, if the

value of their certificates exceeded the total amount of their assessments, they would receive refunds. Should the total value of certificates tendered fall short of the amount assessed the difference would become payable on the due date.

5. It is suggested that the new method of assessment be first applied to incomes earned by private companies for year ended June 30, 1945, or substituted accounting period.

6. For accounting purposes the company could:
   (a) Debit the tax payable for any year against the profits of that year, and declare dividends out of the balance "net," or
   (b) keep the tax paid in a separate account and credit that account with the amounts applied to dividends declared "gross."

   The total value of the Certificates of Credit issued would not, of course, exceed the tax paid.

7. In the case of Government loan interest which is subject to tax at 1930 rates the company would pay 1/4 in the £ as at present and would only deduct 1/4 in the £ from dividends paid out of such interest. The Certificates of Credit issued to shareholders in these cases would entitle them to a rebate at 1/4 in the £.

8. When a company receives a dividend from a private company, the tax could be dealt with in several ways:
   (a) The recipient company could credit the gross amount to Dividends Received Account, and debit the tax deducted to Income Tax Account, which would be cleared when the tax was collected from the shareholders in the recipient company upon redistribution of the dividend.
   (b) The recipient company could credit the net amount to Dividends Received Account, but upon redistribution would notify shareholders of the gross amount to be included in their assessments, issuing a Certificate of Credit for the tax already paid.

Example: A private company earns £12,000 profit during year ended June 30, 1945, and has three equal shareholders, each drawing £1,000 salary. In column (a) it pays an interim dividend in March, 1945, of £3,000 gross (before tax of 13/- in £ deducted) and a further £3,000 in June, 1945; in column (b) it distributes the balance of the profit amounting to £6,000 before June 30.

	(a) If partial distribution made by company in income year		(b) If total distribution made by company in income year	
	Income	Tax	Income	Tax
Taxable Income, £12,000 @ 13/- in £ .. .. Due date, say, April 30, 1946.		£7,800		£7,800
(a) In March, 1945, and June, 1945, the company declared two dividends of £3,000 and paid a cheque for £1,950 (13/- in £) in each of those months to the Tax Commissioner, obtaining credit for		3,900		
(b) The company paid a further dividend of £6,000 in June and paid a further cheque for £3,900 to the Tax Commissioner, obtaining credit for				7,800
		£3,900		Nil

(a) In March and June, 1945, each shareholder received a dividend cheque for £350 and a Certificate of Credit for £650; (b) each shareholder received cheques totalling £1,400 and Certificates of Credit for £2,600.						
Shareholder's Assessment—P.E.	£1,000	£582 7 0		£1,000	£706 2 0	
Property .	2,000	1,350 17 0		4,000	3,064 6 0	
	£3,000	£1,933 4 0		£5,000	£3,770 8 0	
Deduct						
Certificates of Credit (a) 2 @ £650 each; (b) 2 @ £650, 1 @ £1,300		1,300 0 0			2,600 0 0	
Balance payable by Tax Instalment Stamps or group certificates and cash		£633 4 0			£1,170 8 0	
Total assessed to all three shareholders ((a) £1,933/4/- x 3; (b) £3,770/8/- x 3)		5,799 12 0			11,311 4 0	
Paid by company		3,900 0 0			Nil	
Total		£9,699 12 0			£11,311 4 0	
In example (a) the company still has taxed funds of £6,000 gross, or £2,100 net, available for dividend, on which 13/- in £ has been paid, and in respect of which a rebate of 13/- is allowed in shareholders' assessments when dividends are ultimately paid and taxed.						
Total tax payable if assessed as partnership at P.E. rates (£3,530/8/- x 3) ..		£10,591 4 0			£10,591 4 0	

The advantages of the above system of taxing private companies are summarised below:

1. Complicated and delayed private company tax assessments involving reference to shareholders' returns are eliminated, together with further complications relating to determination and assessment of profits subject to rebate under present s. 107.
2. Revenue in the initial stages would be increased because of tax payments on account as dividends are declared and the elimination of delay now occurring in the assessment and collection of private company tax. This increased revenue would be received in the last years of the war when money is needed, and this is a further advantage which should appeal to the Government.
3. The suggested form of tax would permit stability in the post-war period as a reduction in the flat rate could be made concurrently with any reduction in personal rates of tax.
4. Private companies would in future be able to calculate their tax liability accurately and quickly, an impossibility under the existing system.
5. The incidence of the suggested tax is reasonably comparable with the tax payable by a partnership—a test which it appears that any new tax proposals will have to survive.
6. The suggested tax plan, by reason of the collection at the source of tax on dividends, would relieve the Department of administrative problems concerned with extended time for payment of assessments and hardship claims.
7. It would eliminate unsound features of the existing private company tax provisions whereby rating advantages are obtained through a

taxpayer operating more than one private company, or holding shares in and receiving "tax-free" dividends from each of several companies.

8. Under the existing private company tax provisions a carefully considered dividend policy presents opportunities to even out shareholders' incomes as between one year and another. The suggested system lends itself to similar uses. However, such practices are limited and it would appear that the use of property rates as applied to dividends instead of personal exertion rates as applied to partnership businesses would more than compensate the revenue for any loss in tax from this source.
9. Shareholders generally should welcome the tax deduction from dividends because it is virtually an extension of pay-as-you-earn taxation, and they are relieved of the existing responsibility to retain portion of dividends received to meet future tax payable thereon.
10. The suggested tax plan tends to obviate the undesirable features of the present system in regard to the position of small-income shareholders.
11. The change to the suggested tax involves problems in the transition year, including injustices which might occur as between one taxpayer company and another, e.g., some companies would have paid and deducted private company tax assessments on recent years' profits and others would still await assessments. It is suggested that these anomalies would be settled justly if assessments issued after the commencement of the transition year were reduced by, say, 50%, with no deduction of private company tax when paid. (All existing profits which had borne private company tax would of course remain available for "tax-free" dividends, i.e., dividends subject to s. 107 rebates). This suggestion would probably to some extent benefit companies with small-income shareholders and penalise companies with large-income shareholders. However, some adjustment is necessary and, as small-income shareholders have benefited least in the past through the inequalities arising from the allowance of the deduction of private company tax paid, it is probable that such a simple proposal would tend to correct past inequalities.
12. Existing private company tax legislation has had serious economic effects on war-time industries and primary production as there are many private companies operating in these fields. It is thought that Government policy has leaned too heavily on the economic theory that taxpayers will go on exerting themselves to earn additional income, even though taxation allows only a few pence in the £ to be enjoyed from such income. It cannot be contended that the experience of the United Kingdom Excess Profits Tax Act at 100% has proved this theory to be correct because this Act contains generous provisions in the form of elaborate and extensive rebates, designed to provide post-war security to companies putting a maximum effort into the war and submitting to the 100% tax. The Australian tax system contains no similar concessions and it has become evident that directors of many primary producing companies and even war-time industries are unprepared to risk their shareholders' funds in extended enterprise while they are faced with the known fact that any additional profit earned is almost all seized in taxation. The suggested tax plan allows war-time profits to be accumulated for war-time expansion, peace-time reconstruction or future dividends in a possibly lean post-war period, and private companies would be encouraged in further enterprise.

Commonwealth Institute of Accountants
Commonwealth Income Tax Law and Practice

APRIL, 1944, EXAMINATIONS—MODEL ANSWERS

Question 1

A private company paid a dividend of £35,500 out of its net profits and a dividend of £500 wholly and exclusively out of exempt gold mining profits. Its ordinary profit was £40,000 and its exempt gold mining profits £8,000. It may be assumed that the trading profits and the distributable income are the same, namely, £40,000.

What is the undistributed amount subject to additional tax under Division 7? Show workings and give reasons for your answer.

Answer 1

The dividend of £35,500 paid out of the net profit is apportioned as follows:

(a) Portion deductible in ascertaining undistributed amount: $\frac{£40,000}{£48,000 - 500}$ of £35,500 = ...	£29,895
(b) Portion not so deductible: $\frac{£8,000 - 500}{£48,000 - 500}$ of £35,500 = ...	5,605
	£35,500
Distributable income and sufficient distribution	£40,000
Less Dividend deemed to be paid (as above)	29,895
Undistributed amount subject to additional tax under Division 7	£10,105

The above case is governed by s. 103 (2) (f) of the Commonwealth Income Tax Assessment Act, which provides as follows:

"Where dividends are paid either wholly or in part out of the net profits of a company of the year of income and those profits are partly liable to and partly exempt from income tax under this Act the amount of dividends paid out of the taxable income of that year shall be deemed to be the amount which bears the same proportion to the total amount of dividends paid out of those profits as that portion of the net profits of the year of income which is liable to income tax under this Act bears to the total net profits of the company of the year of income:

"Provided that this paragraph shall not apply to the profits or income specified in sub-section (2) of section forty-four of this Act, to the extent of the amount of any dividend paid wholly and exclusively out of those profits or that income."

Question 2

Describe the provisions of the Income Tax Assessment Act relative to any allowance for expenditure incurred for the protection of property from hostile enemy action.

Answer 2

Section 72B (1) of the Act provides for an allowable deduction of expenditure incurred by a taxpayer in the year of income for the purpose of protecting from hostile enemy action:

(a) any persons employed by him for the purpose of gaining or producing assessable income, or

(b) any premises, or part of premises, plant, machinery, implements, utensils, rolling stock, articles, livestock or other property held, occupied or used by him for the purpose of producing assessable income, or in carrying on a business for that purpose.

Where such expenditure creates an enduring benefit to the taxpayer, the deduction is reduced by an amount equal to the value of the enduring benefit (s. 72B (2)).

Where a taxpayer has been recouped or is entitled to be recouped of any amount of such expenditure by the Commonwealth, a State, any public authority or by any other person, the amount so recouped or to be recouped is deducted from the amount otherwise allowable under this section (s. 72B (3)).

Where a taxpayer sells, transfers or otherwise disposes of property on which enemy raids precautions expenditure was made, or where such property is lost or destroyed, the consideration received or receivable in respect of the disposal, loss or destruction, shall, *to the extent* of the expenditure allowed or allowable as a deduction, be included in the assessable income of the taxpayer of the year of income in which the disposal, loss or destruction occurs (s. 72B (4)).

Where the Commissioner makes any disallowance under s. 72B (2), a dissatisfied taxpayer may, within 60 days after service of the notice of assessment, in writing request the Commissioner to refer the claim to a Board of Referees (s. 72B (6)).

The Board of Referees may confirm, increase or reduce the amount of deduction allowed by the Commissioner and the Board's determination is final and conclusive (s. 72B (7)).

Any matter which, under the provisions of s. 72B (6), may be referred to the Board of Referees, cannot be referred to the Board of Review for review (s. 72B (8)).

Question 3

The Income Tax Act states that a taxpayer is entitled to a rebate in his income tax for certain dependants.

Enumerate five classes of these dependants and describe the conditions governing the rebates.

Answer 3

Although the question requires the candidate to deal only with five classes of dependants, the answer hereunder deals with the seven classes of dependants provided by the Act (s. 160):

Class of dependant	Conditions to qualify for rebate	Income limit of dependant	Amount on which rebate calculated	Maximum amount of rebate
Spouse	Must be resident of Australia, wholly maintained by taxpayer.	£50	£100	£45
Female relative . ..	The same as above, taxpayer must be widow or widower, and female relative have care of taxpayer's children under 16 years of age.	£50	£100	£45
Daughter-housekeeper	Taxpayer must be widow or widower; daughter must be wholly engaged in keeping house for taxpayer and wholly maintained by him.	£50	£100	£45

Housekeeper	Taxpayer must be widow or widower; housekeeper must be resident, wholly engaged in keeping house for taxpayer and have care of taxpayer's children under 16 years of age.	No income limit	£100	£45
Children under 16 years of age	Must be residents of Australia, and wholly maintained by taxpayer.	No income limit	First child, £75 Others, £30	£45 £8
Invalid children over 16 years of age ..	The same as above.	Invalid pension	£75	£45
Mother	The same as above.	Cannot be in receipt of any income	£100	£45

Question 4

A taxpayer informs you that he has erected a building which is being used in his business primarily in connection with certain large war contracts.

He asks whether any special provision exists in the Income Tax Assessment Act relative to additional depreciation or recoupment of loss.

Advise him fully.

Answer 4

The Commonwealth Income Tax Assessment Act provides for a special allowance in respect of the loss on sale, or the loss in value, of buildings constructed or acquired by a taxpayer after June 30, 1938, for use primarily and principally in, or in connection with, the prosecution of the present war.

The allowance may also be granted in respect of a loss in connection with alterations, additions or extensions made after June 30, 1938, to an existing building. Provision is also made for an allowance where the taxpayer, in consequence of the construction or acquisition of a building for war purposes after June 30, 1938, has ceased to use any other building which he had used in carrying on his business, and the taxpayer has incurred a loss (not being a loss which is an allowable deduction) as a result of such cessation (s. 59B (4)).

Each application for a deduction under s. 59B must be accompanied by a certificate from the Department of Munitions, the Department of Supply and Development, or the Department of Commerce, or by any other authority which may be prescribed by regulations, certifying that the building or alteration, addition or extension, as the case may be, was constructed or acquired for use primarily and principally in, or in connection with, the prosecution of the present war (s. 59B (2)). New reg. 7A provides that every application for a certificate which is required by s. 59B (2) to accompany any application to the Board of Referees in pursuance of s. 59B (1) shall be supported by a certificate signed by an architect, engineer, builder or other person, approved by the Department of Munitions or other relevant authority, certifying to the best of his knowledge and belief:

(a) the location and description of the building;
(b) the purpose for which the building was erected or, where the application relates to alterations, additions or extensions, the nature, extent and purpose of the alterations, additions or extensions;
(c) the cost of the building, or of the alterations, additions or extensions, as the case may be; and
(d) the name and address of every architect, engineer and builder employed in connection with the work.

Applications under s. 59B may be lodged at any time either prior to, or

within one year (not two years as in the case of plant (s. 59A)) after, the termination of the present war (s. 59B (1)). The certificate referred to in the last preceding paragraph must, however, be obtained from the Department concerned within six months of the commencement of new s. 59B, i.e., within six months of October 6, 1942, or, if the building is constructed or acquired, or if the additions, etc., have been made, after the commencement of the Act, within six months of the construction or acquisition of the building or within six months of the making of the additions, etc. (s. 59B (5)). N.B.: A general extension until June 5, 1943, has been granted for the purpose of obtaining the certificate referred to in this paragraph.

The Commissioner may, in his discretion and upon reasonable cause being shown, extend for a further period, not exceeding sixty days, the period of one year and the period of six months referred to in the last preceding paragraph (s. 59B (6)).

If the taxpayer satisfies the Board of Referees that:

(a) the building or addition, etc., was disposed of prior to July 1 next succeeding the termination of the present war at a price less than its net cost, as defined by s. 59B (4) (b); or

(b) the value of the building, etc., at June 30 next succeeding the termination of the war (or, where the Board determines the question prior to that date but after the termination of the war, the value at the date on which the Board determines the question) is less than the net cost, as defined, of the building, etc.,

and, in either case, the loss under (a) or the deficiency under (b) is wholly or mainly due to conditions arising as a consequence of the present war, the taxpayer will be granted a deduction of an amount ascertained by distributing the loss under (a) or the deficiency under (b) proportionately over the period commencing on the date when the building, etc., was constructed or acquired and ending on the date when the building, etc., is sold or otherwise disposed of in the case of (a), or on June 30 next succeeding the termination of the war in the case of (b), whichever date first happens (s. 59B (3)).

The assessments of the war years in respect of which an allowance is granted by the Board will be amended. By s. 170 (10) no time limit is placed on the issue of such amended assessments (s. 59B).

Question 5

What do you understand by the term "average income" as applied to a primary producer?

What is the "first average year" and how is the first calculation of the rate of tax made?

Answer 5

The Act defines "average income" as applied to a primary producer as being the average of his taxable incomes of the years (called average years) beginning with the first average year and ending with the year of income (s. 149).

The "first average year" is the fourth year before the year of income (s. 150).

For the purpose of making the first calculation of the rate of tax, the first average year shall be the first year which is otherwise capable of being an average year, and in which the taxable income is not greater than that of the next succeeding year. No year prior to that first average shall, on any calculation of the rate of tax, be capable of being an average year.

A year in which the taxpayer was not carrying on business and was not in receipt of a taxable income shall not be counted as a first average year in making the first calculation of the rate of tax (s. 151).

Question 6

A taxpayer purchases an annuity for himself from an insurance company. Will he have to show this annuity in his income tax return as assessable income, and, if so, upon what basis will it be included?

Answer 6

The case is covered by s. 26 (c) of the Act, which provides that the assessable income of a taxpayer shall include the amount of any annuity *excluding* in the case of an annuity which has been purchased, that part thereof which represents so much of the purchase price:

(a) as has not been allowed as a deduction from assessable income under s. 79 (e) of the 1936-1941 Act and its predecessors, or

(b) in respect of which a rebate has not been allowed under s. 160 (2) (f) of the 1936-1943 Act.

Question 7

A company has issued bearer debentures.

What provision is made in the Income Tax Act to ensure that income tax is paid on the interest arising therefrom?

Answer 7

Section 126 (1) provides that where interest is paid or credited by a company in respect of debentures payable to bearer, and the names and addresses of the holders are not supplied by the company to the Commissioner, the company is liable to pay Commonwealth income tax upon the total amount so paid or credited at the rate of tax which would be applicable if that amount were the taxable income of one individual.

Section 126 (2) provides that the company may deduct and retain for its own use from the amount payable to any person, who is a holder of debentures and whose name and address are not supplied, an amount bearing the same proportion to the amount of tax payable by the company under s. 126 as the interest payable to that person bears to the total interest payable in respect of debentures, the names and addresses of the holders of which are not supplied to the Commissioner by the company.

Where the Commissioner is satisfied that a person is not liable to furnish a return, he shall refund to him the amount of tax paid by the company in respect of his debentures (s. 126 (3)).

Question 8

An individual taxpayer is entitled to concessions for certain gifts.

(a) Name seven of these.

(b) State how the allowance is calculated.

Answer 8

(a) An individual taxpayer is entitled to a rebate of tax in respect of gifts of the value of £1 and upwards of

  (i) money; or

  (ii) property other than money which has been bought by the taxpayer within 12 months immediately preceding the making of gift

to the following funds, authorities or institutions in Australia:

  (i) a public hospital;

  (ii) a public benevolent institution;

  (iii) a public fund established and maintained for the purpose of providing money for public hospitals or public benevolent institutions in Australia, or for the establishment of such hospitals

or institutions, or for the relief of persons in Australia who are in necessitous circumstances;

(iv) a public authority engaged in research into the causes, prevention or cure of disease in human beings, animals or plants, where the gift is for such research, or a public institution engaged solely in such research;

(v) a public university or a public fund for the establishment of a public university;

(vi) a residential educational institution affiliated under statutory provisions with a public university, or established by the Commonwealth;

(vii) a public fund established and maintained for providing money for the construction or maintenance of a public memorial relating to the war which commenced on the fourth day of August, One thousand nine hundred and fourteen, or the third day of September, One thousand nine hundred and thirty-nine;

(viii) a public institution or public fund established and maintained for the comfort, recreation or welfare of members of the armed forces of any part of His Majesty's dominions, or of any allied or other foreign force serving in association with His Majesty's armed forces; and

(ix) the Commonwealth or a State, when made for purposes of defence (s. 160 (2) (g)).

Both residents and non-residents are entitled to the rebate in respect of gifts to the above funds, authorities or institutions in Australia. The total amount of the rebateable gifts cannot exceed an amount equal to the taxable income.

(b) The rebate allowance is calculated by applying to the total amount of rebateable gifts the rate of tax appropriate to a taxable income from personal exertion equal to the total taxable income of the taxpayer.

The Consolidated Statement of Assets and Liabilities—II

By G. E. FITZGERALD

An examination paper in October, 1942, contained a Holding Company question which included both a subsidiary and sub-subsidiary companies, and its solution has been the subject of some discussion. Actually, the question was quite straightforward and was not one that might have been expected to cause difficulty to anyone with a good knowledge of the principles involved in consolidation.

The question read as follows:

"Company A purchases 75% of the issued shares of Company B and 80% of the issued shares of Company C. Company C purchases the remaining 25% of the shares of Company B.

After these purchases are completed, the respective balance sheets of the three companies are as under:

Liabilities and Capital—	A £	B £	C £
Current Liabilities	18,360	7,294	8,169
Company A—Advance Account		15,000	
Paid-up Capital (in £1 shares fully paid)	150,000	60,000	80,000

Profit and Loss Appropriation Account	6,916	4,832	7,960
Reserves	18,500	11,300	7,500
	£193,776	£98,426	£103,629
Assets—	£	£	£
Current Assets	23,700	35,196	17,317
Fixed Assets	20,076	58,230	63,312
Company B—Advance Account	15,000		
Shares in Company B	60,000		20,000
Shares in Company C	75,000		
Goodwill		5,000	3,000
	£193,776	£98,426	£103,629

Prepare a consolidated balance sheet of the three companies."

The only points at issue in this question are the respective amounts to be shown in the consolidated statement for Goodwill and Minority Interests.

It is proposed to discuss alternative solutions based on two different methods of dealing with the goodwill appearing in the balance sheets of the subsidiary companies.

We must first ascertain the amount of goodwill arising from the purchase of the shares in "B" and "C" Companies. This may be taken as the difference between the cost of those shares and the amount of the net tangible assets backing for them. Applying this principle, we get the following:

"B" Company

Current Assets	£35,196
Fixed Assets	58,230
Total Tangible Assets	93,426
Less Liabilities	22,294
Net Tangible Assets	£71,132

"A" Company buys 75% = £53,349
for 60,000

therefore £6,651 is the amount of goodwill arising from the purchase of shares by "A" Company.

"C" Company buys 25% = £17,783
for 20,000

therefore £2,217 is the amount of goodwill arising from the purchase of shares by "C" Company.

"C" Company

Current Assets	£17,317
Fixed Assets	63,312
Shares in "B" Company	20,000
Total Tangible Assets	£100,629
Less Liabilities	8,169
Net Tangible Assets	£92,460

"A" Company buys 80% = £73,968
for 75,000

therefore £1,032 is the amount of goodwill arising from the purchase of the shares.

If we follow the method adopted in the previous article of this series[1] and adjust the balance sheets of the subsidiary companies to show Minority Interests and the adjustment for goodwill, before proceeding to amalgamate them with the holding company's balance sheet, we get the following:

"B" Company

Adjusted Balance Sheet

Current Liabilities	£7,294	Current Assets		£35,196
Company "A" Advance	15,000	Fixed Assets		58,230
Company "A" Capital Investment	60,000	Goodwill— Purchase by:		
Company "C" Capital Investment	20,000	"A" Company	£6,651	
		"C" Company	2,217	
				8,868
	£102,294			£102,294

"C" Company

Adjusted Balance Sheet

Current Liabilities	£8,169	Current Assets	£17,317
Minority Interests	18,492	Fixed Assets	63,312
Company "A" Capital Investment	75,000	Shares in "B" Company	20,000
		Goodwill	1,032
	£101,661		£101,661

The remainder of the solution is merely a matter of arithmetic, which may best be illustrated by the following working paper:

Liabilities—	A	B	C	Total
Current Liabilities	£18,360	£7,294	£8,169	£33,823
Paid-up Capital	150,000			150,000
Reserves	18,500			18,500
Profit and Loss Appropriation Account	6,916			6,916
Minority Interests			18,492	18,492
Company "A" Advance		15,000		Cancelled by Contra
Company "A" Capital Investment		60,000	75,000	
Company "C" Capital Investment		20,000		
	£193,776	£102,294	£101,661	£227,731

1. *The Australian Accountant*, Vol. XIV, p. 23.

Assets—				
Current Assets	£23,700	£35,196	£17,317	£76,213
Fixed Assets	20,076	58,230	63,312	141,618
Company "B" Advance	15,000			Cancelled
Shares in "B" Company	60,000		20,000	by
Shares in "C" Company	75,000			Contra
Goodwill		8,868	1,032	9,900
	£193,776	£102,294	£101,661	£227,731

The consolidated statement would then appear as follows:

"A" COMPANY LIMITED

Consolidated Statement of Assets and Liabilities (incorporating the Balance Sheets of "A" Company Ltd. and its subsidiaries "B" Company and "C" Company)

Liabilities		*Assets*		
Current Liabilities:		Current Assets:		
"A" Company	£18,360	"A" Company	£23,700	
"B" Company	7,294	"B" Company	35,196	
"C" Company	8,169	"C" Company	17,317	
	£33,823			£76,213
Outside Shareholders (being the amount attributed to the shares of "C" Company not held by "A" Company)	18,492	Fixed Assets:		
		"A" Company	£20,076	
		"B" Company	58,230	
		"C" Company	63,312	
				141,618
Paid-up Capital	150,000			
Reserves	18,500	Goodwill:		
P. & L. Appropriation A/c	6,916	"B" Company	8,868	
		"C" Company	1,032	
				9,900
	£227,731			£227,731

If we decide to retain the goodwill appearing in the balance sheets of the subsidiaries and adjust the amount up or down for any difference between cost and total assets backing of shares purchased, the working would be as follows:

Calculation of Goodwill on Purchase of Shares

"B" Company—	
Paid-up Capital	£60,000
Reserves	11,300
Profit and Loss Account	4,832
Surplus of Assets over Liabilities	£76,132

"A" Company buys 75% = £57,099
for 60,000

therefore £2,901 is the additional goodwill arising from the purchase by "A" Company.

"C" Company buys 25% = £19,033
for 20,000

therefore £967 is the additional goodwill arising from the purchase by "C" Company.

"C" Company—

Paid-up Capital	£80,000
Reserves	7,500
Profit and Loss Account	7,960
Surplus of Assets over Liabilities	£95,460

"A" Company buys 80% = £76,368
for 75,000

therefore £1,368 is the deduction from goodwill arising from the purchase.

The adjusted balance sheets of the subsidiary companies would then appear as follows:

"B" Company

Adjusted Balance Sheet

Current Liabilities	£7,294		Current Assets		£35,196
Company "A" Advance	15,000		Fixed Assets		58,230
Company "A" Capital Investment	60,000		Goodwill	£5,000	
		Add purchase by "A" Company		2,901	
Company "C" Capital Investment	20,000	*Add* purchase by "C" Company		967	
					8,868
	£102,294				£102,294

"C" Company

Adjusted Balance Sheet

Current Liabilities	£8,169		Current Assets		£17,317
Minority Interests	19,092		Fixed Assets		63,312
Company "A" Capital Investment	75,000		Shares in "B" Company		20,000
		Goodwill		£3,000	
		Less Purchase by "A" Company		1,368	
					1,632
	£102,261				£102,261

This treatment involves two variations in the consolidated statement presented previously. "Goodwill" will appear at £10,500 and Outside Shareholders at £18,492. These variations are not material, because the amount shown for Outside Shareholders is merely an adjustment figure to be deducted from net assets in order to ascertain the equity of the holding company's shareholders in the assets of the consolidation.

What Factory Management Expects of Cost Accounting

By A. G. GIBBS, B.E., A.M.I.E. (AUST.)

(being some comments in a discussion at the Annual Meeting of the South Australian Division of the Institute of Cost Accountants)

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1. *An Appreciation of the Work of the Engineer*

In asking for the work of the engineer to be fully recognised by the cost accountant, I am using the engineer's outlook and practical experience as a basis for pointing out what has been accomplished in industry and, by a direct comparison of his methods, called up certain requirements on the part of the cost accountant.

As engineers have been foremost in pioneering the idea of scientific management and have made great progress in this direction, it is only reasonable that the cost accountant should be asked to recognise this fact. One of your members (Mr. Standish), who lectures in cost accounting, has very nicely put it as follows:

"We need to remember two important things:

"*First,* that it was an engineer who first told the accountant how out of date his methods were in the modern world of production, and who, after condemning him in strong terms for the vast waste of money in compiling useless figures, pointed the way to what we now know as standard costing.

"*Second,* that the accountant has the genius of the engineer to thank for the wonderful mechanical aids at his disposal, in the form of calculators, bookkeeping machines, tabulators, etc., which are now indispensable in any accountancy or costing system.

"For centuries the accountant had been working along retrospective lines in preparing statements showing the results of the operations of last month and last year, in filling and admirably filling, the function of business historian.

"The engineer, on the other hand, had always lived in the future more than in the past. Foresight with him was necessarily a habit, for obviously he could not wait until the bridge was constructed to determine whether it would stand the stresses to which it would be subjected. The viewpoints of the engineer and the accountant were, therefore, diametrically opposed—the one always looking to the future, the other always to the past."

2. *An Understanding of the Engineer's Requirements*

The costing system is something closely connected with the internal organisation of the works, and the organisation cannot be "ready made" if it is to suit the works completely. Thus also, the costing system has always more or less to be adapted to the peculiarities of work, and that excludes, of course, standardisation in the strict sense of the word.

In order to convey further the need for understanding the shop's requirements, I would like to mention some of the points raised by the past President of the Australasian Institute of Cost Accountants (Mr. J. R. McKenzie) in an address on cost accounting last year.

Mr. McKenzie suggested that there were three principles the accountant should keep continually in mind.

The *first* of these is that engineers think in terms of action. When a fact is presented to an engineer, he wants to know what should be done about it or what he can do about it. If it doesn't call for action, why bother about it?

Secondly, engineers deal with men, and men are individuals. They have to operate through these individuals, and if figures are to help them obtain action, these figures must be broken down until they relate to individuals.

The *third* principle is that in order to control a situation efficiently, the factors making up that situation must be separated and dealt with individually. This is the only method by which it becomes possible for management to assess responsibility, and by which it is possible for those responsible to take corrective action.

Cost accounting takes its place in industrial management, defining, analysing and co-ordinating in itemised detail every contributory cost of production and distribution. This reveals weaknesses to the shop that may be eliminated and discloses stronger elements that can be used as starting points for improved efficiency.

In discussing the engineer's requirements in detail, I am going to ask the cost accountant to think of them in terms of the methods and aids used in an engineering shop. I have selected the following functions, expressed in a different form, to serve as a comparison:

(a) The planning of the project.
(b) The draughting of the details.
(c) The machining of the many pieces.
(d) The checking of the finished product.
(e) The scheduling of all the requirements.
(f) The teamwork for production.

3. *That the Cost Accountant is Progressive and is a Good Planner*

The usual approach to an enquiry into past performance by the cost accountant is to drape everything with black crepe and to bring along all the atmosphere of the funeral parlour. Coronial enquiry is not a branch of accountancy and the role of business historian is best left to the sales manager.

It is vital that accounting information be based on current present-day facts and not on the ancient history of pre-war figures. Historical costs can serve but one purpose, to record past performances for income tax purposes. Management must have information that deals with the present—to-day—presented in terms of to-day's values, and with to-morrow's probable values as well.

The engineer lives in the future and the cost accountant lives in the past, and the probable reason for this is because the future cannot be calculated with sufficient accuracy to pass an auditor and it is far safer to rely on history.

Accountants have been slow to accept new methods, both in the revision of forms used for gathering and recording information, and in the application of new ideas.

The forward planning of projects and expenditure basically starts from the engineering side. It is done with a formidable list of unknown factors, but with the idea of foreseeing as many of these as possible to prevent waste due to lack of proper equipment, lack of proper method, etc. There are often so many conditions which may be doubtful that a detailed estimate is a waste of time. On the other hand, weather forecasts (based on an abundance of data) are given with the best of intentions but often finish wide of the mark.

In the broad sense, the engineer's purpose in life is to produce new things and devise new processes to the end that more people may have more things at less cost.

It is not always possible to measure all the factors that can show a saving, and express them in accurate terms of money as required by many people. A broad outlook is required on matters other than direct labour saving. The approach should not be purely clerical but as practical as could be expected.

There is a theory of probability which states that if an event can happen in X ways and fail in Y ways the probability of happening is $\frac{X}{X+Y}$, and that

the probability of failure is $\frac{Y}{X+Y}$. The probability of happening or failing is $\frac{X+Y}{X+Y} = 1 =$ a certainty. No doubt this theory was formulated by a cost accountant to protect himself in any ambiguous case.

An economist said before the war: "Forced accounting has probably been the greatest factor in bringing about and prolonging the present period of prosperity." By forced accounting he meant the accounting that the income tax laws forced on business. It means that business has been forced into the use of certain tools for the measurement of its activities, which have proved useful, but it points to the need for being progressive.

Risk is inherent in all commercial enterprises, and the function of the engineer is not to avoid it, but to appraise it. It is more often commonly guessed, but the cost accountant has to distinguish between a gamble and a speculation.

I have made these points on progress so as to get joint thinking along the lines which will give the best results with a sharing of responsibility and a mutual desire for improvement.

4. *That He has an Analytical Mind*

Mr. McKenzie defined cost accounting briefly as "accounting for cost in a scientific manner in order to exhibit the economics of production and supply of products and services." The exhibiting of the economics of production calls for a man with an analytical mind.

In asking for an analytical mind, I must stress the need to remember that the microscope is not the tool of the cost accountant. We have seen in the past the efforts of accountants to supply a mass of figures broken up into the smallest detail with the idea that they are meeting the demands of the engineer for cost information.

The shop can take a machine that has broken down and dismantle it into its components to ascertain the trouble and so remedy the fault. Likewise with new manufacture and other studies, the draughtsman or engineer arrives at the elements, and applies his reasoning from this analysis. He tries to avoid unnecessary pieces if forgings, or castings, can be made. He defines the limit to which a unit is to be studied, by placing a tolerance on the dimensions, thus we get the translation of the original analysis into the complete product.

In the same way the cost accountant is expected to break his figures down to the necessary limit, and show them in such a way that the engineer can readily determine the factors which are unimportant and those which need close attention and control. He should not ask for unnecessary details which reflects in the building up of the staff to secure them.

In dealing with the economics of production, the engineer relies on correct analysis which should throw weaknesses into relief and thus enable corrective action to be taken speedily. It should indicate if changes must be introduced in the methods or materials in order to better efficiencies.

Cost accounting should embody the analysis and synthesis of cost transactions in such a manner that it is possible not only to disclose the total cost of a product, but also to afford a method of measurement and means of control.

5. *That He has the Equivalent of the Modern Machine Tool*

The engineer has at his disposal a very wide range of machine tools from which to select, the most efficient one which, at least cost, will produce a finished shape and surface, of the required accuracy. New tools are being invented by the keenest minds in great numbers, and the engineer makes regular studies to see if some new machine tool has not come on the market

with which he can produce greater net profits on existing business, or additional profits from new business.

In the same way, the cost accountant is expected to develop a modern business tool as it is indispensable in industry. Sharp, accurate and effective production tools are the result of scientific research and study, accurate design, quality workmanship and the use of first-class materials. So it is with the tools of management.

The tool of cost accounting must have the following attributes if it is to be effective:

(a) It must be based on scientific study and research of the problems in the industry of which the business is a part.
(b) It must be based on facts and conditions pertaining to the particular and individual business to which it is to be applied.
(c) It must be worked out and applied by a craftsman, familiar with all of the finer points of his accounting craft. He must have a broad-minded view of the economics of business, and a definite knowledge of how to apply them.
(d) It must be so designed that modern methods are used, methods that have been the result of years of development and progression.

6. *That He Can Make an Intelligent Comparison of Costs*

The comparison of costs is likened to a comparison of standard in the shop, wherein it can be accurately established as to whether two different materials or parts are similar or not. The engineer has his laboratory and metrology checks which give him the necessary figures for this purpose, and he looks to the cost accountant for a similar service in comparing costs.

Arising from the huge outputs of to-day is the question of comparing costs of producing the same article at different centres. Whilst to a certain degree some portion of the work of making such comparisons must fall within the scope of the cost accountant, there is of necessity a wide field for the services of the engineer in this direction.

As an example, suppose we are dealing with a comparison of costs of a particular product which is being manufactured at two branches of the same company. It will be assumed that we are given particulars of the costs under the usual three main headings of labour, material and overhead charges. Here are a few of the points to be considered:

(a) Comparison of accuracy and finish. Much criticism of costs arises from lack of agreement on these points, although it should be appreciated that identity in these two features by no means implies agreement in manufacturing methods.
(b) Method of manufacture. This often has a distinct bearing on material costs as well as on labour costs. Thus one can imagine an item made from a pressing with a relatively light amount of material loss, and alternatively being produced as a forging, with a much heavier material weight.
(c) Processes. There are processes such as heat treatment, the labour costs of which may be spread over the whole output or allocated to a particular item.
(d) Quantities. Costs should be based on similar quantities to avoid complications of set-up costs, etc.
(e) Extent of tooling. The tooling approach can be widely different and out of proportion to the work involved.
(f) Grade of labour. This includes type as well as degree of skill.
(g) Type of machine and plant. This is an item which varies tremendously and requires most consideration.

I have gone into a little detail on this point in order to emphasise the necessity for a technical approach as well as for some kind of standardisation of the costing system to give a fair comparison. It should also be appreciated that the limits of comparison must be kept in mind when drawing conclusions from such studies.

There can be many sources of mistakes if the figures collected in any two cases are not built upon the same basis. This means an intelligent approach with a standardisation of notions. This should be regarded as an essential aim of the cost accountant, rather than take the pessimistic view that a really just comparison of costs of products from two different sources is impossible.

7. That He Can Give a Good Presentation of Data

In introducing the subject of presenting data to the shop, I must tell the story of the Minister for Production who was asked to give some idea of aircraft production. The Right Honourable gentleman expressed himself as follows: "I am happy to inform you that our weekly output of aeroplane rudders is, even at this early stage, greatly in excess of anything achieved during the entire periods of the Crimean and Boer Wars combined." There is a moral in this for cost accountants.

The manufacturing engineer has at his disposal schedule graphs, machine loading graphs, labour graphs, etc., all of which enable him to watch performance and provide for pending variations. The one weakness in his operations is lack of an up-to-date picture of his cost trend.

Most companies have the necessary machinery required for the determination of the various cost elements and the problem usually resolves itself primarily into one of presenting this data to the management in the most usable form. The ultimate aim in the accumulation of data on past performance should be directed towards their adaptability in the budgeting of future operations under conditions of varying volume.

In addition to this, the cost accountant should place the data concerning the economics of the venture before the management in such a form as to give guidance in formulating the policies to be pursued.

The suggestion is made here for more consideration to be given to graphical presentation of data to indicate trend. The graphs should show how expense should change with production changes, and thus afford a means of control. A graph is much easier to follow than a mass of figures, and can be used for budgeting as well as for expense control.

The graphs should be based on manufacturing conditions in effect at a particular time and by assuming the amount of direct labour for a month, it should be possible to find approximately the manufactured volume and all the expenses associated with this volume.

Although the primary purposes of the graph would be to indicate trends the fundamental accuracy would depend on the accuracy of the data from which they are developed.

Normally, mechanical efficiency is subordinate to financial efficiency. The former can be fairly easily determined, but there is very little measure of the latter other than where discovered by the auditor.

It is also necessary to mention the engineer's understanding of figures. The shop is accustomed with all jobs (however accurate) to having some tolerance which is expressed in dimensional form. It is requested that this should be understood and recognised by the cost accountant in dealing with estimates and costs.

The man in the shop may give some figures as a quote, but when he sees it much later, after it has been through the mysterious rites of cost accounting, he cannot recognise it. Likewise, when it comes to the distribution of burden, there seems to be a lot of mystery and wangling on the subject. This calls

for the presentation of data in a language which the shop will readily understand.

8. *That He is Co-operative*

Whatever the troubles and setbacks experienced in the design, tooling and tryout of a job, there still remains the big problem of production. At this stage it is still possible to make good some of the ground lost as far as final costs are concerned by concerted teamwork on the part of the production group. They can accept the shortcomings of some of the tools and the equipment by concentrating to achieve the desired result with the spirit of co-operation.

Increasing criticism is jeopardising the future of accounting and the value of much professional research based upon it. It has been stated that accounting must either revise its concepts or be reduced to a level of secondary importance in industry. I would like to quote what a modern text-book on Industrial Management thinks of the future of the cost accounting department:

"Fundamentally cost accounting is a functional division of the regular accounting department. It is fully realised that the cost accounting group is by no means always found in this relationship. In actual practice, the cost accounting department may be found under the methods or standards department; under the plant superintendent, general manager, or some other important official. At the time of the establishing of cost accounting as a separate function, there may have been good reason for placing the cost work under the regular accounting division. Tradition and the momentum of an early start may keep this up long after the original cause has been removed. Good cost accounting requires a thorough knowledge of production processes (not necessarily a technical knowledge) which often is lacking in the regular accounting section. This factor is frequently the determining factor in locating the cost accounting department."

I throw out as a challenge to the cost accountant, for him to come into the shop and play ball with us. He is a vital part of the organisation and can be our guiding star. We look to him to read the stars rather than point the bone. We would rather he was a poker player than a collector of stamps. We prefer him as a crystal gazer rather than a coroner.

As this is a debate, and I am representing the engineer, I have purposely been hypercritical of the cost accountant. I must take the opportunity, however, of saying that I have attempted to draw up a specification rather than find faults with individuals.

In conclusion, I thank you for being so patient whilst I put the cost accountant through the Magnaflux Test to show where possible weaknesses exist.

What Cost Accounting Expects of Factory Management

By ALEX. MOFFATT, A.C.A.A.

(being some comments in a discussion at the Annual Meeting of the South Australian Division of the Institute of Cost Accountants)

The answer to this question is to be found by going among cost accountants and asking; but before doing so I tried the inverse procedure with amazing result. I found that factory management dreaded a conciliation because it left no one to abuse. Cost accounting, to them, is a psychological escape from their faults, a kind of well-padded seat of pants that can be kicked

furiously and often when things go wrong. This left me wondering whether it was advantageous for industry to try to bring about an understanding, when they supplied (after the usual abuse) the answers I had expected from the cost accountants. They know what cost accounting expects of factory management, but unless we preach it loud and often the "seat of the pants" complex will override reasonableness.

The production or technical man is, naturally, keenly interested in creating, and his appreciation and satisfaction comes from planning, producing and overcoming technical difficulties. When these have been mastered and the completed product leaves his care, there is a tendency to be "off with the old and on with the new." To him, costs and sales in no way help to produce the product, they are not even ancillary to the product; in fact, they are usually discarded as someone else's worry. But costs and sales are everyone's worry, because the real motive behind any business is profit and this leads us to the first thing we expect of factory management: *"An appreciation that business is conducted for profit."* Yet we have to spend as much time defending this truism as refuting a fallacy.

With this profit motive in mind it will show why cost accounting expects these other attributes:

1. *An Interest in the Financial Side of the Business*

There should be a desire to know that as well as producing the product perfectly, the minimum cost has occurred. That figures can show the why and wherefore, giving sufficient information to enable action to be taken or praise to be passed on. This latter is something not fully appreciated by factory management. Ever ready to question figures which discredit their performance, they overlook the advantages and efficiencies that could be obtained by passing on creditable performances while pointing out the faulty. Their ambition should be to take as much pride in producing economically as in producing mechanically perfect.

2. *Co-operating with the Cost Accountant to Secure Accurate Costs*

What are the standing jokes of most industries—those yarns of incorrect bookings. Of people who have booked telephone numbers, people who have been away from a company for years and come back and immediately booked their old job number; yet bookings are indirectly related profit and from there to the wages or purchasing power of the individual and so the community. Far-fetched, maybe, but analogous to the old saw about "for want of a nail, etc."

3. *Watch Labour Bookings*

This is the corner-stone on which the structure of costs is built and unless laid correctly the whole structure is faulty. Engineers who would not tolerate wrong figures appearing on a blue print are apt to take little account of even gross errors on a time card or requisition. It is realised that booking job numbers day after day becomes mechanical and leads to carelessness, but if figures are to be worth anything they must be accurate. As with labour, so with material—it should be properly recorded and used. Too often the usage is related to the capital of a company and such expressions as "they've got plenty and what does a bit of waste amount to" are common. Waste of any kind, whether in peace or war, is a national as well as a company loss. But while both items mentioned are more or less of a physical nature, with limits of utility which can be gauged, there is an intangible cost which requires strict supervision, manufacturing expense. It is incredible the amount that can be added to cost by excess usage of lighting and power, lost time through faulty scheduling, losses and errors and the many other expense items so

well known. Among the intangibles to be watched is labour turnover; the financial effect is difficult to value, but the cost is assuredly high. It can be caused by mishandling employees, lack of human understanding and by accidents. These are responsibilities which cost accounting expects factory management to appreciate.

4. *An Interest in the Economics of Manufacturing*

Cost accounting expects factory management to approach the economics of manufacturing as if they owned the business, not on the basis of what is the best way but what is the best and most economical way. Under this heading are several things and, firstly, "planning and tooling." This is technical and it cannot be expected that the cost accountant is familiar with the detail, that responsibility must be left to factory management. There must, however, be close co-operation so that costs of alternative methods can be analysed, remembering that the cost must be absorbed in the product. Continual comparison of the estimated cost with the work in progress is necessary so that if there is any indication of an overrun, consideration can be given to alternative methods or revised selling prices.

Secondly, plant rearrangements, and here the bogey of "the company has plenty of money" again rears its head. It is easy to walk through a factory and be tempted to make a rearrangement or when a new product has to be developed to consider the purchase of new and expensive machinery (the company can afford it), and to make a rearrangement to facilitate operational routing. But before this is done the economics must be studied. It may be undisputed that a rearrangement will reduce costs, but will the saving, because of volume, offset the rearrangement cost?

Thirdly, the same investigation is required of the function of inspection. It must be considered from economy, whether it is more economical to have more scrap and less inspection, or vice versa, the correct position must be obtained and held.

By correct design of equipment and tooling, inspection can be more or less eliminated.

Fourthly, by understanding and using the budget as a means to secure internal control and to measure performance. Here it is as well to examine a few of the advantages of a budget:

(a) Establishing a definite goal to attain.
(b) More continuous operation and greater regularity of employment.
(c) Products, process and equipment can be standardised.
(d) Costs can be used as control rather than historical information.
(e) To serve as a measuring stick to compare actual performances with promises and standards.

It can be seen that these are important so that when called upon to supply information for the preparation of a budget every care should be taken and the services of the cost accountant sought. Likewise, when the information has been issued, it should be critically examined and items not understood should not be ignored. Ask for information and reasons why. And finally, learn what it is all about before discussing or criticising, and here I offer a suggestion. Why not introduce into engineering courses a short course on cost accounting and appreciation of figures, so that when this vital information is supplied it will be understood.

And so we pass on to co-operation. Neither factory management nor cost accounting can work as divisions; each is essential to the whole and cost accounting expects this co-operation. By pointing out where anything is going wrong, by showing savings and, above all, by asking what is meant if

figures do not convey a clear picture instead of throwing them aside as so much tommyrot.

In conclusion—it can be said that cost accounting expects of factory management:

1. An appreciation that business is conducted for profit.
2. An interest in the financial side.
3. Correct cost data.
4. An interest in the economics of manufacturing.
5. Co-operation.
6. The introduction into the engineering courses of a short course on cost accounting and appreciation of figures, a phase which at the present moment is almost disregarded in engineering courses—in other words, learn what it is all about before you talk.

Principles of Production Planning and Production Control in Modern Factory Organisation

By D. J. Garrick

In war time, when all resources of the nation are mobilised for Victory as the common goal, the task of every industry is to produce quicker, cheaper and better, with the minimum waste of material, machine capacity and man-power, and the maximum efficiency with its consequent increase in quality, quantity and deliveries.

In a few articles I propose to give a short and condensed description of how this can be accomplished and what is necessary for any industry to cope successfully with this manifold task which might look simple, but is in its details very intricate.

As every movement or happening in an industry is originated by men and carried out by men, we can safely say that every organisation depends on men. To stimulate men to act with their full powers and to direct their efforts are the daily operating tasks of organisation management. But where their number begins to become large these men must work within some established arrangement of their mutual relationship, which constitute the form or structure of their organisation. Just what structure will prove to be the best for any organisation depends upon the specific task it is meant to perform, the kind of men it can get and the particular conditions under which they work. Even the determination of the ways in which any organisation may best be divided into working sections and departments is relative to its own peculiar aims and conditions. But organisation is not an end in itself; it can, however, increase or decrease the effectiveness of those who operate under it.

An organisation, as a whole, is composed of two main factors:

1. Co-ordination.
2. Co-operation.

Co-ordination is a process whereby the activities of each person in an industry are systematically directed by a chief executive toward the completion of a task in a certain length of time in accordance with a prefixed plan, which has to provide means for the most effective transmission of the chief executive's decisions and for the linking up of all activities into a unified whole.

Co-operation means working together for a common end in such a way that each man performs his work to the best of his ability, voluntarily and helpfully.

Co-operation is a matter of goodwill exercised by subordinates. Co-ordina-

tion is a matter of proper leadership exercised by the chief executive. But the best co-operation cannot lead to efficiency without co-ordination, and the best co-ordination fails without proper co-operation. Subordinates have to co-operate, executives have to co-ordinate and co-operate.

Co-ordination, as we have seen, is, in other words, a system which ensures the proper and smooth functioning of an organisation. A system, on the other hand, is a routine by means of which activities of an industrial organisation are carried on and controlled. The smaller an industry is the less co-ordination is necessary and a very simple system will be sufficient to carry on and to control, but not even the smallest—the "one man's business"—can be efficient without a system. The bigger the industry is the more detailed and intricate its system becomes, involving a large number of men who are co-ordinated by, and are to co-operate under, the system.

Production Planning and Production Control are some of the most vital and important parts of modern Factory Organisation.

Except in a few very well managed industries the conflict between the manufacturing and controlling departments is an often experienced evil, able to upset the best planned system. The producing departments of an industrial undertaking often regard the planning and controlling of the production as a "hobby" of the executive, or call it "just unnecessary red-tape." They regard the manufacturing itself—the mechanical production of the article—as the only important part of the industry and do not realise that, for the management, there are other vital viewpoints to be taken into consideration.

To make clearer what is meant by the importance of Production Planning and Control, let us take as an example a ship, which sails. The captain of the ship before departure plans on a chart the exact route of the course of his ship, calculates the distances and the time which the pre-planned trip will take and makes the necessary provisions for food, water, fuel, etc. During the journey he continuously controls the course of his ship by the compass. The ship might arrive at its destination without a compass, but only after a considerable, sometimes catastrophic, delay and waste of time, fuel and food—or it might never arrive, but perish.

This example applies, I think, best to an industry where the captain is the manager or the management, the chart is called Production Plan and the Production Control works as the compass. The stokers and machinists who feed and operate the machines which keep the ship moving are of the most importance, alike to the productive departments of an industry, but without the compass in the hands of the captain they might get lost together with the ship. As the compass enables the captain to make *immediately* the necessary correction on the course of his ship, so the properly working Production Control indicates to the management any deviation from the plan and is the only instrument by which they can determine what steps are to be taken *without delay* for correcting the course of production to keep it within the plan.

The system of an industry includes, and should include, the co-ordination of all sections and departments, but by the word system in this article we mean only the system embracing the Production Planning and Production Control. Although the Production Planning is incomplete without the consideration of a fair amount of highly important technical details, as factory lay-out, transport problems, adequacy of plant and machinery, etc., we will leave this field of the planning to the technicians and concentrate only on the administrative side of it.

The administrative side of a system means "paper work" requiring numerous different blanks and forms. It must be continuously employed to achieve results. Its function, purpose and aim must be laid out very clearly. It has to be developed from careful analysis and study of its problems, must

be in any case flexible, not rigid, and corresponding in its details and volume to the actual requirements of the concern.

Unfortunately, in many industrial firms the system is crude and is introduced in bits and pieces as need arises, not according to a pre-arranged plan. It creates a situation which is called "under-organised," or, in other words, lack of proper co-ordination without established routine. In such situation these routines are—to a greater or less extent—a matter of personal knowledge of certain individuals, and the absence or removal of such person endangers the whole frail structure of the system and it collapses.

But equally dangerous might become the other extremity of a system, what is called "over-organised," where unnecessarily numerous blanks and forms are used, resulting in the recording of data of no practical value and making the system cumbersome and difficult. This type of organisation is usually bound to become rigid, where the slightest change in the production involves a huge amount of alteration in the forms and in the routine of the control system, and in case the changes in the production are numerous or drastic it gets entangled to such extent, that it cannot cope any more with them and loses its control value. Instead of being a "report" dealing with actualities, it becomes "history" recording the past.

No efficiency in production can be obtained without proper planning and adequate control. Both of them deal with the basic elements of production, the so-called unity of three "M's", which are:

Men + Machines + Material.

The unity of these three factors and their dependability on each other is self-explanatory, since no production can be performed in the absence of any one of them. The best machines with any amount of material will not turn out production and no man can produce on a machine without material or be efficient without adequate machinery.

The purpose of Production Planning is to reduce the mental labour of production to a minimum, by co-ordinating the above-mentioned three "M" factors in a well studied and thoroughly analysed system, which has to define the routine for the following four principal questions of production:

1. What to do.
2. How to do it.
3. Where to do it.
4. When to do it.

The purpose of the Production Control, on the other hand, is to record the facts of the performance of production during its course, and through collecting this data to answer continuously the above four principal questions, showing whether—

1. What has to be done, *is done.*
2. It is done *the way* it has to be done.
3. It is done *where* it has to be done.
4. It is done *when* it has to be done.

In other words, the Production Control's purpose is to check continuously on whether, according to the Production Plan (if the planning is proper), the highest efficiency in production is obtained by producing the required quantity of the required quality, at the required time, by the best and most economic method.

Unfortunately, very few industrial concerns and manufacturing firms do yet realise to its full extent the importance of proper Planning and Control. Idle labour, machinery not used to full capacity, waste of material and falling

down on promised delivery dates are the consequences of the lack of these two very important sections in the Factory Organisation, and, while these conditions prevail, efficiency, which is most vital in production, cannot be obtained.

Book Review

The Art of Accountancy

Designed mainly for students, a second edition of *Intermediate Accountancy* has been published by Consolidated Press Ltd.

The authors, Messrs. E. Bryan Smith and J. P. Glasheen, refer in the preface to the need for an inexpensive publication within the range of intermediate students. Based upon accountancy methods that are commonly used in Australia, they have therefore written this manual for those who are preparing for an accountancy diploma, are in the University faculties of Economics and Commerce, or are taking accountancy as a study subject for other examinations.

The eighteen chapters of subject matter into which the book has been divided have been supplemented by a number of examination papers and an index. Avoiding, as far as possible, the use of obscure technicalities, the authors have made their book a text book of utility, not only for examinees but for business men who are charged with the responsibility of controlling an office.

W. Bruce Rainsford.

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